VZCZCXYZ0004
RR RUEHWEB

DE RUEHBU #0515/01 0651128
ZNR UUUUU ZZH
R 061128Z MAR 06
FM AMEMBASSY BUENOS AIRES
TO RUEHC/SECSTATE WASHDC 3707
INFO RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOC/USDOC WASHDC
RUEHRC/USDA FAS WASHDC 2099
RUEHC/DEPT OF LABOR WASHDC
RHMFISS/HQ USSOUTHCOM MIAMI FL

UNCLAS BUENOS AIRES 000515

SIPDIS

SIPDIS

PASS FED BOARD OF GOVERNORS FOR PATRICE ROBITAILLE
TREASURY FOR DAS LEE, RAMIN TOLOUI AND CHRIS KUSHLIS
NSC FOR SUE CRONIN
AND OCC FOR CARLOS HERNANDEZ
USDOC FOR ALEXANDER PEACHER
USDOL FOR ILAB PAULA CHURCH AND ROBERT WHOLEY
USSOUTHCOM FOR POLAD
OPIC FOR GEORGE SCHULTZ AND RUTH ANN NICASTRI

E.O. 12958: N/A
TAGS: EFIN ECON ELAB ALOW AR
SUBJECT: Argentina Economic and Financial Weekly for the week ending March 3, 2006

-- --------
Weekly Highlights
-- --------

- The peso was unchanged against the USD, closing again at 3.08 ARP/USD.
- The IDB approved a USD 500 million loan to Argentina.
- The GOA is considering reopening the Boden 2015.
- Banks pay back ARP 2.4 billion to the BCRA for rediscount loans.
- The BCRA is considering increasing bank liquidity requirements.
- Tax revenues rose 27 percent y-o-y to ARP 10.5 billion in February - in line with market expectations.
- January trade surplus of USD 837 million - in line with expectations.
- Unemployment down 1.0 percent q-o-q to 10.1 percent in Q4 2005.
- Commentary of the Week: "Price Agreements Only Provide Short-Term Help"

-- --------
MARKETS
-- --------

-- --------
The peso was unchanged against the USD this week, closing again at 3.08 ARP/USD.
-- --------

¶1. The peso remained flat versus the USD this week, closing at 3.08 ARP/USD. The peso depreciated one cent to 3.09 ARP/USD early in the week, after the Central Bank (BCRA) purchased USD 29 million in the FX market on February 27. By mid-week, strong investment inflows to purchase domestic stocks and bonds, coupled with seasonal peso demand (due the "beginning of the month" effect) allowed the BCRA to purchase USD 234 million in the first four days of the week without any peso appreciation. The BCRA has purchased USD 1.7 billion since the beginning of the year, compared to

USD 734 million during the same period last year. The peso exchange rate has depreciated 1 percent since the beginning of the calendar year.

-- --------
ECONOMY / FINANCE
-- --------
-- --------
The IDB approves a USD 500 million loan to Argentina.
-- --------

¶2. On March 1, the Inter-American Development Bank (IDB) board finally approved the USD 500 million public sector financial management adjustment loan to Argentina. The board's decision had been delayed since February 22, because Directors wanted more time to review it and more details about the purpose of the loan. This loan is the first adjustment loan received by the GOA not under the umbrella of an IMF program. The loan is to support a sector program to increase effectiveness, efficiency and transparency of public sector financial management. The program covers four policy areas: macroeconomic environment, strengthening of public investment, financial management and public debt systems. The loan is for a 20-year term, with a five-year grace period at a variable interest rate, to be disbursed in two tranches, the first of USD 150 million and the second of USD 350 million. Conditions for disbursement consist of a matrix of agreed-upon requirements based on maintenance of a stable macroeconomic environment and reform measures in each of the areas covered by the program.

-- --------
The GOA is considering reopening the Boden 2015.
-- --------

¶3. On March 2, La Nacion reported that the GOA is considering issuing a new USD bond. During the week, Secretary of Finance, Alfredo MacLaughlin met with

SIPDIS
banks and investors in New York and Chicago to explore the possibility of a new issuance. Reportedly, the GOA first envisioned issuing a USD bond under New York legislation, but has decided to issue under domestic legislation because of the risk of attachment by bondholders. Press reports speculated that the GOA will reopen the Boden 2015, a USD-denominated bond with a 7 percent coupon, amortizing fully at maturity in 2015 and under domestic legislation. The GOA first issued USD 632 million worth of Boden 2015 in October
¶2005. According to traders, the Boden 2015 may be reopened at a yield of 8.00-8.20 percent.

-- --------
The GOA sells USD 308 million worth of Boden 2012 to Venezuela.
-- --------

¶4. On February 27, the GOA published in the Official Gazette a resolution authorizing the issuance of USD 308 million worth of Boden 2012 bonds to Venezuela. This debt sale is Venezuela's third purchase of GOA debt this year, and had already been leaked to press. The purchase brings Venezuela's 2006 GOA bond purchases to USD 929 million (face value) and USD 750 million market value. In 2005, the GOV purchased USD 1.9 billion worth of GOA bonds (USD 1.6 billion market value).

-- --------
Italian bondholders group says it will file for ICSID arbitration against the GOA.
-- --------

¶5. On March 2, the Italian association of holdout bondholders (TFA) stated that it plans to file an

arbitration claim against the GOA before the World Bank' International Centre for Settlement of Investment Disputes (ICSID), seeking repayment of its members' bonds. Reportedly, on March 27 the TFA will start receiving subscriptions from Italian investors to negotiate on their behalf against the GOA. The Italian law firm Grimaldi e Associati and the New York firm White & Case will be the legal consultants. In February 2005, the Global Committee of Argentine Bondholders (GCAB) had announced that it would file for ICSID arbitration against the GOA, but it did not follow through, apparently because of the length of the expected proceedings.

--- --------
President Kirchner opens the regular Congressional session.
--- --------

¶6. In his speech opening the regular Congressional session on March 1, President Kirchner reiterated his commitment to fiscal discipline. He referred to inflation as a transitory phenomenon caused by rapid economic growth and a rise in export prices, but he warned businessmen to behave cautiously to avoid "the greed of some that diminishes the people's consumption capacity." He also warned union leaders about their claims for salary increases that might generate price pressures due to cost increases. Regarding utility companies, President Kirchner said that his "hand will not tremble" if it is necessary to nationalize any privatized company. He also said that the GOA will not force any company to stay in Argentina if that company believes it is losing money.

--- --------
Aguas Argentinas is unlikely to renew guarantee, forcing the GOA to rescind its contract.
--- --------

¶7. On February 28, El Cronista reported that Aguas Argentinas (AA) -- controlled by Suez -- will not renew an ARP 145 million guarantee. If AA does not renew this guarantee before the end of March, the GOA will have the right to rescind the concession contract. Analysts say that Suez's strategy is to force the GOA to rescind AA's concession contract. Suez used a similar procedure to force the Province of Santa Fe to rescind the concession contract with Aguas de Santa Fe, which was controlled by Suez.

--- --------
BCRA rolls over its maturities. Investors concentrated more than 65 percent of their bids in Nobacs.
--- --------

¶8. The BCRA received ARP 723 million in bids in its February 28 Lebac auction, less than the ARP 850 million in Lebacs that came due during the week. However, the BCRA received bids of ARP 1.4 billion in its Nobac auction. [Nobacs are longer term instruments - compared to Lebacs - and pay a variable rate composed of base rate called Badlar -- the interest rate for deposits of more than ARP 1 million, currently at 7 percent -- plus a spread. The BCRA auctions the spread on its Nobacs, while the Badlar is determined by market conditions.] As in the previous auctions, the BCRA was more than able to roll over its maturities by accepting bids for ARP 1.8 billion (ARP 723 million in Lebacs and ARP 1.1 billion Nobacs). The yield on the 49-day Lebac dropped 8 basis points to 6.75 percent. The yield on the 70-day Lebac decreased from 7 percent to 6.97 percent, and the yield on the 91-day Lebac reached 7.25 percent. Lebacs for other maturities were withdrawn due to lack of interest. Investors concentrated more than 65 percent of their bids in Nobacs of more than 9 months

and the BCRA accepted bids for ARP 1.1 billion of Nobacs (61 percent of the accepted amount in the auction). The spread on the nine-month Nobac decreased one basis point from 3.13 percent to 3.12 percent, while the spread on the two-year Nobac dropped from 5.57 percent to 5.40 percent. Investors are increasing their bids in Nobacs, since these instruments have a variable rate and provide a higher yield (10.2 percent and 12.4 percent for the 9-month and 2-year Nobac, respectively).

-- --------
Banks pay back ARP 2.4 billion in rediscount loans to the BCRA.
-- --------

¶9. On March 2, two banks - Banco Galicia and GOA-owned Banco Nacion - pre-paid ARP 2.4 billion in discount borrowing to the BCRA. With this payment, Banco Nacion has completely repaid its BCRA debt, while Banco Galicia still holds 58 percent of its original discount borrowing from the BCRA. This prepayment, plus the banks' payment of an ARP 275 million installment of the matching system (under which banks repay the BCRA for financial assistance received during the 2001 financial crisis) will generate a monetary base contraction of ARP 2.6 billion. Following these pre-payments, only three banks - out of twenty-four at the beginning of the 2002 crisis - will have outstanding discount borrowing from the BCRA, totaling ARP 6.7 billion.

-- --------
The BCRA is considering increasing bank liquidity requirements.
-- --------

¶10. The BCRA is considering increasing bank liquidity requirements for sight accounts (current and savings accounts). According to the local media, the BCRA is considering a 3 percentage point increase in bank liquidity requirements from their current level of 15 percent. If the measure is implemented, ARP 1.9 billion would be absorbed from the financial system, assuming that private and public sector deposits total ARP 63.9 billion. The BCRA is considering the increase as a way to withdraw money from the market in order to curb inflation.

-- --------
GOA closes new price-restraint agreements.
-- --------

¶11. On February 27, the GOA reached a verbal agreement with the Compressed Natural Gas (CNG) retail sector to freeze the price of CNG until the end of the year. This new price-restraint agreement is expected to be formalized next week, because the GOA has to reach an accord with the leading CNG producers in advance. Reaching an agreement with the CNG sector, which is being used increasingly as a vehicle fuel in Argentina, is key to the GOA's anti-inflation effort. Separately on February 28, the GOA closed a new price-restraint agreement with representatives of the Pharmaceutical Chamber. The agreement aims to introduce a 10 percent discount on 216 basic medicines for a period of 2 months.

-- --------
Tax revenue rose 27 percent y-o-y to ARP 10.5 billion in February - in line with market expectations.
-- --------

¶12. February federal tax revenue increased 27 percent y-o-y to ARP 10.5 billion - in line with market expectations of ARP 10.4 billion. The results reflect strong economic activity. Labor contributions jumped 44 percent y-o-y due to increases in formal job

creation, salary increases and the inclusion of past increases into the base salary used to compute benefits. VAT revenues rose 31 percent y-o-y. Income tax and trade tax revenues increased 24 percent and 20 percent y-o-y, respectively. According to the GOA, the increase in tax collection is due to VAT, income tax revenues and labor contributions, which together provided 73.2 percent of February tax collection. In real terms, revenues increased 13 percent y-o-y. The BCRA consensus survey forecasts 2006 tax revenues at ARP 137 billion.

January trade surplus of USD 837 million - in line with expectations.

¶13. The January trade surplus reached USD 837 million, in line with the BCRA consensus forecast of USD 823 million and similar to last January's surplus of USD 872 million. Export revenues increased 14 percent y-o-y (decelerating slightly from 2005 average growth rate of 16 percent) to USD 3.2 billion, with increases in both prices (+10 percent) and quantities (+4 percent). Exports were driven by an increase in agro-industrial products (+24 percent y-o-y), fuel and energy (+17 percent y-o-y), primary goods (+12 percent y-o-y) and industrial goods (+2 percent y-o-y). Imports increased 22 percent y-o-y to USD 2.3 billion, with increases in both quantities (+18 percent) and prices (+3 percent). Imports were driven by increases in vehicles for passengers (+ 121 percent), capital goods (+26 percent), consumer goods (+25 percent), intermediate goods, fuel and oil (+15 percent) and accessories for capital goods (+12 percent), but were partially offset by a drop in other goods (-18 percent). According to the BCRA consensus survey, the trade surplus is expected to narrow to USD 10 billion in 2006 compared to USD 11.3 billion in 2005.

Unemployment down 1.0 percentage points q-o-q to 10.1 percent in Q4 2005.

¶14. The GOA announced that the unemployment rate dropped 1.0 percent q-o-q to 10.1 percent in the fourth quarter of 2005, reflecting the strong economic growth during the period. According to the GOA survey, a total of 1.1 million people are unemployed out of a workforce of 10.8 million. Unemployment decreased 2.0 percentage points y-o-y. Excluding Head of Households Plan participants, the unemployment rate stood at 12.7 percent, versus 16.2 percent in Q4 2004.

February labor demand index down 2.81 percent m-o-m.

¶15. The February labor demand index calculated by Di Tella University decreased 2.81 percent m-o-m to 123.55 points. The decrease is mainly due to weaker demand for commercial employees (down 5.24 percent), service sector employees (down 4.23 percent) and professional employees (down 3.11 percent). The index is increased 26.2 percent y-o-y. [The index is based on comparisons of job vacancy announcements printed in the two largest newspapers of the country.]

February Government Confidence Index down 0.4 percent m-o-m.

¶16. The Government Confidence Index decreased 0.4 percent m-o-m in February to 2.62 points, but is still 3 points above the average during the Kirchner administration, and well above the 1.2 point reading

in May 2003 when President Kirchner took office. Confidence in the GOA's ability to solve citizens' problems is still the factor generating the most confidence and it increased 1 percent m-o-m. Public opinion of GOA general performance and efficiency of public spending decreased 3 percent and 1 percent m-o-m, respectively. The index rose 10 percent y-o-y. [The Government Confidence Index is a survey-based index prepared by Di Tella University. It varies from zero to five points and seeks to measure public opinion of GOA general performance, efficiency of pubic spending, honesty of GOA officials and the government's ability to solve problems.]

-- --------
Commentary of the Week: "Price Agreements Only Provide Short-Term Help". By Ernesto Gaba. [Note: Translated and used with permission of the author, from an article published January 31 in El Cronista Comercial. End Note.]
-- --------

¶17. The country's economic recovery continues at full speed: in 2005 GDP will show 9 percent growth while in 2006 we expect growth to reach 7 percent. Salaries will continue to grow and spur private-sector consumption in 2006, but with a slowing in employment growth and in real salaries.

¶18. Among economic sectors, the strongly cyclical activity in construction will continue to be a leader in growth. Despite cost increases, cQstruction remains an attractive investment opportunity because of high real estate asset values in dollar terms. During 2005, the growth differential between goods and services decreased, with service costs being propped up by the increase in financial intermediation for the first time in four years. The gradual normalization of the financial system has fostered a recovery of profitability and solvency among banks, although banks' net worth in real terms remain lower than they were pre-crisis.

¶19. The dynamism of exports in 2005 is supporting the recovery for the first time since the abandonment of convertibility in 2002. The lag -- relative to Brazil -- that Argentina's exports have experienced in responding to a relatively cheap peso was likely due to the economic disruption that followed the devaluation, in addition to climatic and technological factors affecting primary goods.

¶20. The new Minister of Economy, Felisa Miceli, will maintain the fiscal surplus and depreciated peso policies, since these have the backing of President Nestor Kirchner. It is possible that in this new stage, there will be less reliance on adjustments via market mechanisms than on price agreements in the fight against inflation. Such a policy of price agreements can help contain inflation in the short run, but it is not a substitute for a combination of monetary and fiscal policies geared toward stabilization in the medium term.

¶21. President Kirchner's announcement that Argentina would prepay its IMF debt of approximately USD10 billion with Central Bank reserves came as a surprise. The goal of this decision was to increase the GOA's flexibility in its political and economic decision-making, which traditional IMF conditionality limits as part of its financial assistance programs. Paying the Fund has no economic implications in a static sense, since the consolidated public sector net external assets (Treasury + Central Bank) do not change when debt is reduced at the same time that Central Bank reserves are reduced. Moreover, after the IMF payout, Central Bank reserves have continued supporting the

monetary base (defined as money in circulation + banks' deposits in the Central Bank) at the exchange rate of 3.00 ARP/USD.

¶22. Nevertheless, in a dynamic sense, the IMF payout could create two weaknesses, under certain circumstances. First, if Argentina were to need liquidity because of an external shock, there would be questions about its ability to turn again to the IMF, while market financing would come at a much higher cost. Second, the Central Bank acquired reserves in recent years by issuing debt (repo agreements and LEBACs). As a consequence, the Central Bank's reserves/liabilities ratio could be adversely affected by the IMF payout. In this new environment, it is possible for the market to discount a relatively cheap peso as well as higher inflation and higher domestic interest rates. [Note: We reproduce selected articles by local experts for the benefit of our readers. The opinions expressed are those of the authors, not of the Embassy. End Note.]

GUTIERREZ